

EBS/85/285

CONFIDENTIAL

December 19, 1985

To: Members of the Executive Board
From: The Acting Secretary
Subject: Tanzania - Real Effective Exchange Rate - Information Notice

Attached for the information of the Executive Directors is an information notice on the real effective exchange rate of the Tanzania shilling.

Mr. Belanger (ext. 8671) is available to answer technical or factual questions relating to this paper.

Att: (1)



INTERNATIONAL MONETARY FUND

TANZANIA

Real Effective Exchange Rate--Information Notice

Prepared by the African Department and
the Exchange and Trade Relations Department

(In consultation with the
Legal Department and the Research Department)

Approved by A. D. Ouattara and S. Kanesa-Thasan

December 19, 1985

The recent evolution of Tanzania's real effective exchange rate, as measured by the standard index developed in connection with the information notice system, is set out in the attached table and chart. ^{1/} Based on this index, as of September 1985 the Tanzania shilling had appreciated in real effective terms by more than 10 percent since the last occasion on which the Executive Board had an opportunity to discuss Tanzania's exchange rate policy--the 1984 Article IV consultation in December 1984. The appreciation is estimated to have amounted to 14.0 percent.

The Tanzania shilling has been pegged to a composite of the currencies of Tanzania's main trading partners since January 20, 1979, when the shilling was devalued by 10 percent and its peg to the SDR was discontinued. Subsequently the shilling remained stable in terms of the U.S. dollar at around T SH 8.9 = US\$1 until March 8, 1982, when the rate was depreciated by 10 percent. Further depreciations followed on June 6, 1983 of 20 percent, and on June 14, 1984 of 26 percent, resulting in an exchange rate of T Sh 17 per U.S. dollar. Despite these actions, as of the end of 1984, the real effective appreciation since end-1979 had amounted to 107 percent.

The further real effective appreciation of 14 percent during the period December 1984 - September 1985 has taken place as a result of the relatively high rate of domestic inflation (27 percent on an annual basis) ^{2/} as the nominal effective rate has remained fairly stable. These developments have brought the cumulative real appreciation of the Tanzania shilling as of September 1985 to 136 percent since end-1979.

^{1/} The consumer price index in Tanzania is available on a quarterly basis only. For the purpose of the information notice system, monthly data are derived by interpolation of the seasonally adjusted quarterly series.

^{2/} Data for the third quarter of 1985 were extrapolated.

As the real effective exchange rate index is based on the official consumer price index, which has been influenced by widespread price controls and subsidies, the extent of real appreciation could be even higher. These developments have led to the emergence of a parallel market where the prevailing exchange rate is reportedly three to five times higher than in the official market.

At the conclusion of the 1984 Article IV consultation on December 7, 1984, Executive Directors expressed deep concern about the continued and severe deterioration in Tanzania's economic situation over the past several years. 1/ It was noted that inappropriate price relationships, most notably an overvalued exchange rate, and expansionary financial policies were in large part responsible for the disappointing economic trends. Directors welcomed the policy changes introduced in the context of the 1984/85 budget, including the currency devaluation in July 1984, but noted that stronger and more comprehensive measures were required to achieve a sustainable external position and economic recovery. Similar considerations were stressed by Executive Directors at the time of their discussions of Tanzania's overdue obligations to the Fund on July 21, 1985, August 26, 1985 and November 25, 1985. 2/ As indicated in the staff papers for the Board discussion of Tanzania's overdue obligations, a staff team held inconclusive discussions with the Tanzanian authorities in March 1985 on an adjustment program to be supported by the use of fund resources. Furthermore, some of the adjustment measures undertaken last year were reversed, while no major policy initiatives were announced with the introduction of the 1985/86 budget. There are also indications that the economic and financial situation is becoming increasingly serious, as evidenced by a steady build up of external arrears (including to the Fund and the World Bank), negative economic growth, and an increasingly large divergence between the parallel and official market exchange rates of the Tanzanian currency.

A mission is now in Dar es Salaam to hold the Article IV consultation discussions, in the context of which the staff will re-emphasize the need for a strong and comprehensive program aimed at achieving progress towards viability of the external sector.

1/ Chairman's summing-up circulated as SUR/84/119 (12/13/84).

2/ Based on "Tanzania - Overdue Financial Obligations to the Fund - Report and Complaints Under Rule K-1 and Rule S-1 and Notice of Failure to settle Trust Fund Obligation," EBS/85/155 (6/19/85), and EBS/85/198 (8/21/85); and "Tanzania - Overdue Financial Obligations to the Fund - Review of Decision on Complaints Under Rule K-1 and Rule S-1, and Notice of Failure to Settle Trust Fund Obligations," EBS/85/256 (11/20/85).

Table 1. Tanzania: Real Effective Exchange Rate and Related Series

(Indices: 1980 = 100)

	Real Effective Exchange Rate <u>1/</u> <u>2/</u>	Nominal Effective Exchange Rate <u>1/</u>	Relative Consumer Prices (Local Currencies)	Exchange Rate in Terms of U.S. Dollars <u>1/</u>	Consumer Price Index (Seasonally Adjusted)	Consumer Price Index (Not Seasonally Adjusted)
Yearly						
1978	94.6	110.0	86.0	106.0	67.5	67.5
1979	88.6	99.5	89.1	99.8	76.8	76.8
1980	100.0	100.0	100.0	100.0	100.0	100.0
Quarterly <u>3/</u>						
1981						
I	119.7	109.1	109.7	99.7	116.1	115.6
II	134.6	119.4	112.7	98.9	122.5	120.1
III	140.6	122.2	115.1	98.1	128.3	129.6
IV	141.7	119.8	118.3	98.6	135.2	137.2
1982						
I	148.2	119.8	123.7	92.9	144.0	143.3
II	148.3	116.0	127.9	86.9	152.8	149.4
III	165.9	118.0	140.7	85.3	171.1	173.5
IV	172.0	118.8	144.8	85.2	179.2	181.8
1983						
I	180.2	121.1	148.9	83.9	187.2	186.1
II	180.4	112.7	160.1	75.9	205.4	200.3
III	158.9	102.7	154.8	66.2	203.6	206.9
IV	177.6	105.7	168.1	65.9	226.5	230.0
1984						
I	187.3	104.3	179.6	66.4	246.8	245.0
II	170.6	89.7	190.3	54.2	266.5	259.9
III	170.9	83.5	204.8	46.3	292.5	297.6
IV	183.1	85.4	214.3	45.5	313.6	318.3
1985						
I	200.4	89.0	225.4	44.4	337.7	335.1
II	202.7	87.7	231.2	46.5	353.4	344.5
III	208.7	86.2	242.3	47.7	375.1 <u>4/</u>	...
Monthly						
1984						
Dec. <u>5/</u>	183.1	85.4	214.3	45.5	313.6 <u>6/</u>	...
1985						
January	189.0	86.6	218.4	44.8	321.4	...
February	196.1	88.3	222.0	44.3	329.4	...
March	200.4	89.0	225.4	44.4	337.7	...
April	197.8	87.2	226.8	46.1	342.8	...
May	200.6	87.6	229.0	45.9	348.1	...
June	202.7	87.7	231.2	46.5	353.4	...
July	203.6	86.8	234.7	47.8	360.5	...
August	203.8	85.5	238.4	48.0	367.7	...
Sept.	208.7	86.2	242.3	47.7	375.1	...
Percentage change						
Dec. 1984- Sept. 1985	14.0	0.9	13.0	4.9	19.6	...

Source: Information Notice System.

1/ Increases mean appreciation.

2/ Using seasonally adjusted price indices.

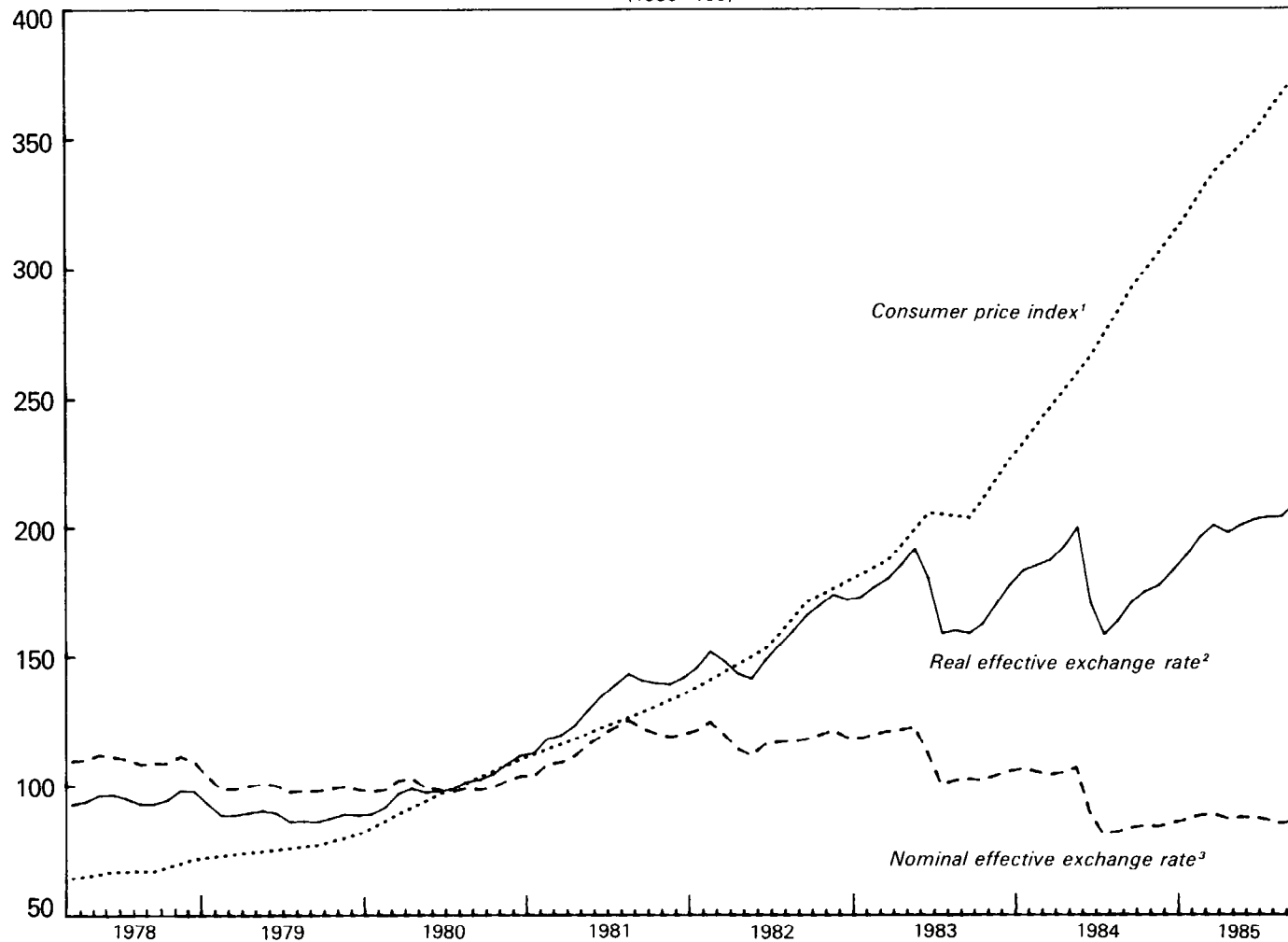
3/ End of quarter.

4/ Extrapolation based on rate of inflation in two preceding quarters.

5/ Date of latest consideration by Executive Board.

6/ Monthly data derived by interpolation of seasonally adjusted quarterly series.

CHART 1
TANZANIA
REAL EFFECTIVE EXCHANGE RATE
AND RELATED SERIES
(1980=100)



Source: Information Notice System.

¹Seasonally adjusted.

²Trade weighted index of nominal effective exchange rate deflated by seasonally adjusted consumer prices; increase means appreciation.

³U.S. dollars per Tanzania shilling (index).